Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Developing a Unified Intercarrier	)	CC Docket No. 01-92
Compensation Regime	)	

COMMENTS OF PARRISH, BLESSING & ASSOCIATES

I INTRODUCTION

Parrish, Blessing & Associates, Inc. ("PBA") hereby submits its comments in the above captioned proceeding.[1] PBA is an economic consulting firm located in Ft. Washington, Maryland. Its clients primarily include mid-size local exchange carriers ("Mid-Size LECs") in Puerto Rico, the U.S. Virgin Islands, Alaska, the continental United States, and South America.

As PBA demonstrated in 1999, Mid-Size LECs differ from the largest LECs in the nation in significant ways.[2] They generally range in size from 89,000 access lines to 1.8 million access lines, while large companies range

[1] In the Matter of Developing a Unified Intercarrier Compensation Regime, Notice of Proposed Rulemaking, CC Docket No. 01-92, Released April 27, 2001 ("NPRM"). A summary of the NPRM appeared in the Federal Register (Vol. 66, No. 100) on May 23, 2001, thus establishing due dates for comments of August 21, 2001, and reply comments of October 5, 2001.

[2] In the Matter of Petition for Forbearance of 2% Mid-Size Local Exchange Companies, Differences Between Mid-Size and Large Local Exchange Carriers and the Resulting Regulatory and Competitive Implications (by David C. Blessing of PBA), April, 1999. The Commission granted part of this petition and addressed other parts in Orders released June 30, 1999 in FCC 99-108 and FCC 99-105. This study is incorporated herein by reference.

from 6.7 million access lines to over 40 million.[3] Mid-Size LECs generally serve smaller metropolitan markets, suburban and rural areas. Many of these companies operate as holding companies consisting of widely dispersed serving areas which are predominately rural. All Mid-Size LECs lack the scale economies of the large carriers. As addressed below, it is critical for the Commission to recognize the unique characteristics and concerns of Mid-Size LECs in this proceeding.

II. BACKGROUND

Prior to the decade of the 1960s, AT&T was the only provider of long distance service. LECs were exclusive providers of local telephone service in their franchise areas. Long-distance and local telephone services were regarded as natural monopolies, or utilities like electric and municipal water distribution services. These services were capital-intensive, and best provided, under regulation, by a single designated supplier.[4] AT&T was initially regulated under a program of "continued surveillance" under which informal, private negotiations with the Commission were used to set rates. In the early 1960s, the test was whether AT&T's return on investment was getting close to what was then felt to be a reasonable level of 8%. When this

[3] id., fn. 1. 47 U.S.C. §251(f)(2), as amended in 1996, establishes an upper bound for Mid-Size LECs at less than 2% of the nation's access lines installed in the aggregate nationwide.

[4] See Cap-Sized: How the Promise of the Price Cap Voyage to Competition Was Lost in a Sea of Good Intentions, Gregory J. Vogt, *Federal Communications Law Journal*, March, 1999, pg. 349-401 (cited hereafter as "Vogt"). Vogt recounts the history of local exchange carrier regulation beginning at pg. 354.

occurred, AT&T's interstate rates would be reduced.[5] By the middle 1960s, technology had made possible competitive long-distance entry, and the Commission adopted a formal rate-of-return regulation approach. The purpose of this regime was to prevent AT&T from squeezing out competitors because of its then vast size and resource capabilities compared to new entrants. In short, rate-of-return regulation was seen as a substitute for market forces to protect the consumer. This system of regulation was also applied to LECs by state regulatory commissions, and, after divestiture of AT&T, this Commission.

Vogt explains that rate-of-return regulation is essentially a "cost-plus" approach under which the regulated entity is allowed to earn a reasonable return on its net investment and be compensated dollar-for-dollar for costs it incurs.[6] The Commission increasingly came to the conclusion that rate-of-return regulation provided incorrect incentives for a competitive environment, and in the late 1980s, it moved toward price cap regulation, first for long-distance carriers (now termed "interexchange carriers", or "IXCs"), then, in 1990, for large LECs.[7] Under this system, a company's index of prices for a particular category of services, i.e. the category's "price cap", for a given year is set by adjusting the previous year's cap by inflation,

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[5] id., pg. 356, citing Telecommunications Policy for the 1980s: The Transition to Competition; by Walter G. Bolter, et.al.; Prentice Hall, Inc. (1964).

[6] id., pg. 359.

[7] Large LECs included the 7 then existing regional Bell operating companies ("RBOCs") and GTE. See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report & Order, CC Docket No. 87-313, 5 FCC Rec. 6786 (1990)("1990 Price Cap Order").

reducing it by an offset for productivity gains, and then lastly by including the impacts from exogenous (i.e., out of the company's control) cost changes. While this appears simple, the Commission has tinkered with the system continuously since that time, constantly trying to guard against what it has viewed as excessive LEC profits.

The initial productivity factor levels were 3.3% or 4.3% depending on the earnings-sharing levels a company thought it could achieve in a given year.[8] In 1995 the productivity factor became 4.0%[9], followed by a jump to 6.5% in 1997[10]. Thus, the price cap regime has presented carriers to which it applies with an elusive goal: as soon as they make productivity gains sufficient to improve their earnings, the Commission has changed the rules to make the hurdle higher.

States too have adopted price cap regimes, many of which are based loosely on the FCC model, and have proceeded to refine them with the passage of time. As Vogt notes, state refinements include the use of different price caps for different aggregations or "baskets" of services,[11] lower productivity offset factors than that used by the Commission,[12] and abandonment of the use of the add-on "consumer productivity dividend"

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8 id., par. 126.

9 In the Matter of Price Cap Performance Review for Local Exchange Carriers, First Report and Order, CC Docket No. 94-1, 10 FCC Red. 8961 (1995).

10 In the Matter of Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 16,642 (1997), par. 18.

11 Vogt, pg. 385.
12 id.,

employed by the Commission since its initial 1990 LEC order.[13] In completing his analysis, Vogt concluded that the replacement of rate-of-return regulation with price caps has fallen short of the goal of bringing market forces to bear on local service pricing because of the Commission's continuing efforts to "tinker" with the regime.[14] PBA agrees with that assessment, and observes that the moving target aspect of price cap regulation has probably discouraged further company participation, although enthusiasm for this large company regulatory regime has never been high among Mid-Size LECs. While a few Mid-Size LECs have elected price cap regulation, most continue to operate under rate-of-return regulation.[15]

Price cap and rate-of-return regulation both govern the setting of rates for interstate access charges, and are set by the Commission. Similarly, intrastate access charge rates are set by state regulatory commissions. As the Commission notes, access charges are paid by IXCs to LECs for the origination or termination of calls on behalf of the IXCs, and for transporting these calls between the LEC central office switches and the IXCs' points of presence (or "POPs").[16] Commercial mobile radio service ("CMRS") providers also pay access charges for non-local traffic between their facilities and

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[13] id., pg. 386.

[14] id., pg. 401.

[15] Broadwing, formerly Cincinnati Bell Telephone Company, Citizen's Communications, Aliant, now part of ALLTEL Corporation, and SNET, now part of SBC Communications, are price cap electees.

[16] NPRM, par. 7.

those of LECs.[17] Access rates have been set at levels above their true costs in order to keep local rates low, although as noted below, the Commission has reform proceedings underway to remove these implicit subsidies. The access charge system, both federal and state, has been in effect since 1983, with periodic refinements and reform efforts at both jurisdictional levels.

On February 8, 1996, the Telecommunications Act of 1996 became part of the law of the land.[18] This comprehensive amendment to the Telecommunications Act of 1934 established competition as a fundamental element of the nation's telecommunications policy, and required LECs to allow competitive providers to interconnect with their facilities. The 1996 Act also required LECs to establish reciprocal compensation arrangements with other LECs, IXCs or CMRS providers for the transport and termination of local calls on their networks.[19] Paradoxically, these providers are exempt from paying access charges or reciprocal compensation charges when they connect to LEC networks as end users.[20] As the Commission explains in the NPRM, these interconnection rules have presented a series of problems.

The first is *regulatory arbitrage*. This occurs where termination rates are set too high, and has led to the major problem of windfall profits for competitive LECs ("CLECs") and Internet service providers ("ISPs"), who in

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[17] id.

[18] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act").

[19] 47 U.S.C. §251(b)(5).

[20] NPRM, par. 8.

some instances appear to have targeted customers just to receive local traffic.[21]

The second has to do with *terminating access monopolies* which arise because normally end users only subscribe to one LEC, whether ILEC or CLEC. As the Commission notes, many CLECs, with unregulated rates, have charged terminating access rates far above costs to take advantage of this situation.

A third problem is the indication that different network types may require different interconnection rates. This may be due to different cost characteristics, such as for terminating calls on wireless networks, or where CLECs may have deliberately set up their networks to minimize termination costs in order to avail themselves of greater reciprocal compensation revenue.[22]

Problems also include the impact of these balkanized intercarrier compensation rules on end user charge rates, and on the subscription decisions of customers.[23]

In short, the present jumbled state of intercarrier compensation is adversely affecting development of telecommunications service provision in the United States. Simply put, the regulators are standing in the way of progress. The Commission is correct to initiate an inquiry into developing a

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[21] id., par. 11.

[22] id. par. 16.

[23] id., par. 17, 18.

uniform intercarrier compensation regime, and PBA supports the effort to arrive at an equitable solution, but cautions the Commission against stampeding to a pre-judged end result such as bill and keep. Corrective efforts in the short term have begun.

The Commission recently adopted a major access reform proposal for price cap ILECs which establishes rate level and universal service support levels for the period from July 1, 2000 through June 30, 2005.[24]

Similarly, the Commission has sought comment on an industry access reform proposal for the balance of the LEC industry.[25] This plan would be implemented over a five year period beginning in July 1, 2001, although that date has now come and gone. PBA believes this plan would move rate-of-return companies closer to a uniform access charge plan, and would thus be a significant step toward an ultimate uniform plan for intercarrier compensation. The plan has many benefits: It would place rate-of-return LEC customer subscriber line charges ("SLCs") at the same levels as for price cap LECs, lower the composite access rates to 1.6 cents per minute within two years, and give these LECs additional administrative flexibility and a known planning horizon. Swift adoption of this plan by the Commission is in the public interest.

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[24] NPRM, par. 97.

[25] id., citing Multi-Association Group (MAG) Plan for regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, Notice of Proposed Rulemaking, CC Docket No. 00-256, Released January 5, 2001 ("MAG NPRM").

With these efforts either completed or underway, the Commission sees the instant proceeding as taking the next step, one which they hope will be to establish a unified regime covering all forms of intercarrier compensation. But foreseeing the end of CALLS and the MAG plans and predetermining the need for moving intercarrier compensation to a bill-and-keep approach is premature. How these plans will impact customers, companies, and regulatory commissions, including the FCC, is unknown.

As explained below, PBA believes the dark side of what is unfolding here is a thinly disguised effort by the Commission to shift the full burden of non-traffic sensitive loop and transport costs to the end user, which means residential end users in large part. While this may have some intuitive appeal in a theoretical sense it is impractical and unsound in the view of PBA.

III. FCC BILL AND KEEP PROPOSALS WILL HARM UNIVERSAL SERVICE IN AREAS BEYOND METROPOLITAN CENTERS

When AT&T agreed to be broken up on January1, 1984, access charges came into being. Perhaps the most visible component of these new charges was the SLC, which is currently $3.50 per line per month for residential and single-line business customers and $6.00 for multi-line business customers.[26] These charges, and the higher SLC rates to follow

[26] Higher rates are applicable for price cap customers under the CALLS plan, and will apply to other customers when and if the MAG plan is adopted. By July 1, 2003, the $3.50 rate would rise to $6.50 and the $6.00 rate would become $9.20 under these plans.

under CALLS and MAG, make possible lower per-minute access charges to IXCs. These charges are meant to cover part of the non-traffic sensitive or fixed costs of equipment required for both local and long distance services that benefit end users and carriers alike.

Even before divestiture of AT&T, major technology advances had been causing rapid declines in the cost of long distance service and an exponential increase in demand. But in order to keep local rates low, more fixed, local costs were shifted to interstate long-distance. Competition in long-distance services after divestiture brought pressure on this pricing imbalance, which led to passage of the 1996 Act establishing competition as an essential element of national telecommunications policy. But the need to continue to keep local rates at affordable levels in order to preserve and even expand universal service continues. Indeed, the following principle is clearly stated in the Act:[27]

> Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

In the instant NPRM, the Commission now proposes two new approaches to intercarrier compensation. The first is called *Central Office*

[27] 47 U.S.C. §254(b)(3).

Bill and Keep, or "COBAK".[28] The proposal would bar the collection of the costs of the loop serving the customer's premises and the central office serving the customer's loop from an interconnecting carrier. Second, and perhaps more importantly, the calling party's network would be responsible for the cost of transporting the call to the called party's central office, for local calls, or to the IXC POP for long-distance calls, with the IXC responsible for delivery to the called party's central office.

The second Commission proposal is referred to as *Bill Access to Subscribers – Interconnection Cost Split*, or "BASICS".[29] The first rule of this proposal is that all intra-network costs should be recovered from end-user customers. The second rule is that interconnecting networks should divide the costs resulting purely from interconnection equally.

In both plans, the Commission is quietly suggesting that end user customers should pick up the entire loop and central office cost burden, as well as transporting the calls to the IXC POP.[30] Access charges from incumbent LECs to IXCs would appear to vanish. The historic principle begun well before AT&T divestiture of keeping local rates low by passing costs over to long-distance customers, either through access charge structures or universal service subsidies, would appear to be all but abandoned. The requirement in the Act to keep urban and rural rates

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[28] NPRM, par. 23-24. This is the proposal of Patrick DeGraba of the FCC staff, and is sometimes referred to as the "DeGraba Proposal".

[29] id., par. 25-29. This is the proposal of Jay Atkinson and Christopher Barnekov of the FCC staff, and is sometimes referred to as the "Atkinson-Barnekov Proposal".

[30] NPRM, fn. 41.

comparable for comparable services would be all but ignored, which if demonstrated to be true would render the regime unlawful under the Act.

> PBA is concerned over the possible impact of the Commission proposals on its clients' customers. Bearing the full brunt of non-traffic sensitive costs will cause a dramatic increase in local rates in many suburban, rural, insular, and remote areas. Where, as is often true, the subscribers in these areas are in lower economic strata, the result will be to push them off the local networks, or at minimum to vastly increase the burden on universal service to continue providing service to low income customers at current levels. Results such as this are untenable, and the Commission must proceed with the utmost caution, ever mindful of the consequences that regulatory missteps can have on customers' well-being.

A secondary aspect of adopting either of the Commission's bill and keep proposals would be a windfall cost reduction for IXCs. This would be the end result of the process begun in 1984 with the introduction of the initial subscriber line charge. That initial shifting of costs from interstate long-distance to the end user resulted in long distance cost reductions and dramatic increases in usage. This process continued with access charge reform under terms of the CALLs plan, and may happen in rate-of-return company areas if the proposed MAG plan is adopted. The Commission posits a bill and keep proposal as an answer to the question "What comes after CALLs?" (and by extension, after a yet to be adopted MAG plan).[31] But as mentioned above, PBA believes this is premature for rate-of-return LECs in general and Mid-Size LECs in particular. While the CALLs plan is in place for price cap LECs, the MAG plan remains under consideration by the Commission. Actual operating experience under this plan is essential in order to formulate the next step. These LECs have serious cost/price dislocations in their present rate structures that have been resolved for the larger price cap carriers. Operating under MAG will help remove these dislocations, if the Commission approves the plan and gives it some time. Noone can foresee changes that will be necessitated by adoption of this plan, given the extremely diverse nature of the full spectrum of rate-of-return LECs. Consideration and adoption of a comprehensive, new intercarrier compensation plan must be based on several years of actual experience under an adopted MAG plan.

IV. IF THE COMMISSION ADOPTS A BILL-AND-KEEP APPROACH FOR INTERCARRIER COMPENSATION, FUNDAMENTAL GUIDELINES SHOULD BE ADOPTED FOR MID-SIZE LECS

PBA believes the FCC plan to adopt a bill-and-keep approach for intercarrier compensation may be ill-advised (and certainly premature) for many of its client companies, and quite possibly for other similarly situated Mid-Size LECs. Nevertheless, if the Commission decides to move ahead with this approach, it should establish and adhere to the following fundamental guidelines in order to protect the interests of mid-size LECs generally:

First, the drastic increases in local rates and decreases in long-distance rates brought on by a bill and keep approach with the end user customers paying all the non-traffic sensitive costs will obliterate any remaining distinction between the two services. It will truly be the "death of

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[31] NPRM, par. 97.

distance", as some have described it. The fundamental question should then become which provider has captured the end user customer. This means:

- If the LEC keeps the customer, whether residence or business, then it becomes the customer's provider for its *telecommunications services*, not just local services. The LEC would continue providing what had been local services to the customer as in the past. It would also be the provider of its customers' long distance services. The LEC would do this either through its own facilities, or by purchasing capacity – interconnecting – with the facilities of an IXC. But the customer, having chosen the LEC as its telecommunications services provider, would only see the LEC as its provider. From the customer's perspective, this approach would be clean, simple and straight-forward, for a change.

- If the IXC captures the customer, it would be a similar situation. The IXC would provide what had been local service either through its own facilities, or by purchasing capacity – interconnecting – with the LEC. It would provide what had been long distance in the same manner it does today. Again, the customer would see only the IXC as its communications provider. The customer would have one contact, and would receive one bill for all its telecommunications services from the IXC.

- If a CLEC captures the customer, it would similarly provide the complete package. It would provide what had been local service through its own facilities or by purchasing capacity – interconnecting – with the facilities of the LEC, and what had been long distance service through its facilities or by interconnection with an IXC. Again, the customer would see one provider and receive one bill.

- Many customers may choose to receive all their telecommunications services from a CMRS provider. Again, the same result would apply.

PBA believes the above approach would place LECs, IXCs, CLECs, and wireless providers on an equal footing. They would succeed or fail to the degree they could provide quality *telecommunications* services to their customers. If the customers become dissatisfied, they can choose another provider. Good service providers will flourish; poor ones will fall by the wayside. This is open-field competition, not so-called "regulated competition". The latter has never succeeded, and never will.

PBA recognizes that it may be necessary under the above approach to administer a nation-wide round of pre-subscription wherein each customer would select its *telecommunications provider* from a list of those offering service in their areas. If this is done, it should be a joint effort administered by the Commission in partnership with state regulatory commissions. While this would not be without cost and administrative burdens, it would be essential from a customer clarification perspective, and to place providers on an equal footing.

A second aspect of necessary guidelines if the Commission proceeds with a bill-and-keep approach for intercarrier compensation is to levelize the arrangements between communications providers, with meaningful regulatory oversight. This would entail:

- The extension of mandatory interconnection with incumbent LEC local facilities to include mandatory LEC, CLEC and CMRS provider interconnection with IXC facilities.

- Expanded interconnection between providers would proceed much as LEC interconnection does today, i.e. the first choice would be by agreement between the interconnecting parties; if they cannot agree, then state commissions would serve as mandatory arbitrators. The Commission's role would be limited to establishing and enforcing standards to assure seamless nationwide interconnection among all providers.

- All telecommunications providers would be declared non-dominant and detariffed as a first step toward full deregulation at the federal level States would have a period of time to sunset tariff regulation of telecommunications services, e.g. five years. Exceptions would be services in remote areas where there is a single provider.

- In a detariffed and soon to be deregulated environment, costs of service would become secondary to market pricing. It would be the providers' responsibility to provide service at the market price such that it covers its costs and earns a profit.

- Where services remain subject to tariff oversight or in connection with state arbitration of interconnection agreements, costs would exclusively be the carriers' actual costs under the demand levels foreseen within the terms of the interconnection agreement. There would be no further use of idealized, theoretical network costs (the "green fields" approach inherent with the Commission's total element long run incremental costs, or TELRIC, methodology). Actual networks, actual costs, and foreseeable and committed-to demand levels would be the rule, and there would be no exceptions to this.

V. REMAINING ISSUES TO BE RESOLVED

If the Commission moves to adopt a bill and keep approach for intercarrier compensation, and once it establishes the above guidelines, the following issues should be dealt with:

<u>Carrier of Last Resort</u> Carrier of last resort status should only apply where a LEC, IXC, CLEC or CMRS provider is designated as such and is the sole recipient of federal or state universal service support funds. In all other instances, a carrier should be able to offer services or not, as it chooses. If regulatory bodies should continue to require a carrier to be a provider of last resort in specific instances, it is essential that the provider be able to recover the legitimate costs of the firm through a combination of retail services to customers in the affected area, wholesale services to alternative telecommunications providers if any materialize, or, if all else fails, through explicit funds made a part of their universal service support receipts.

<u>Elimination of Meaningless Distinctions</u> Under the competitive, multiple provider of telecommunications services by non-dominant carriers approach outlined above, the need for artificial distinctions and record-keeping now a part of the Commission's rules would no longer exist. Examples of such distinctions include jurisdictional separations and the use of local access and transport areas ("LATAs"). Jurisdictional separations is

used to monitor federal and state levels of revenues, investments and costs. In a detariffed and in many cases deregulated environment, it will no longer matter if a service is interstate, intrastate, local, or toll. What the service is, and the price level faced by the customer will be the only material factors. The jurisdictional separations process can be safely abandoned under this construct. The same can be said for LATAs. LATAs are a creature necessitated by the divestiture of AT&T, the creation of the 7 RBOCs, and line of business restrictions preventing the resulting entities from directly competing with each other. In a future, truly competitive, multi-provider environment, LATAs will serve no useful purpose, and should be eliminated.

Transition Mechanisms In moving from today's regulatory environment to adoption of the MAG plan to an eventual intercarrier compensation regime, whether based on bill and keep or a continuation of today's mechanisms, it is essential to Mid-Size LECs that appropriate transition mechanisms are available to prevent drastic cost, rate, and service changes. The Commission should go slowly here, because the stability and growth of the telecommunications industry is at stake.

Consider Alternative Mechanisms The Commission should not pre-judge the appropriateness of bill and keep as the model for intercarrier compensation. Other mechanisms, such as pricing based on capacity, should be given consideration. Present mechanisms should not be abandoned solely for the sake of moving to bill and keep. Performance of both the CALLs plan and the MAG plan should be carefully assessed over a period of several years' actual data. It will probably be essential to separate the timelines for CALLs companies, which can move more swiftly since CALLs is in place, and MAG companies, since that plan is still not approved. Impacts on other providers, i.e. IXCs, CLECs and CMRS providers, will be dependant on how well these plans work and will dictate the requirements needed by any comprehensive intercarrier compensation plan.

VI. CONCLUSION

PBA believes the Commission should be very cautious in dismantling the regulatory structure it has been constructing since 1984 in favor of an untried, potentially administratively burdensome, and financially harmful bill-and-keep approach. The impact on customers should be carefully assessed, well before making any final decision on regime adoption. If the Commission ultimately decides to proceed with bill and keep, then it must take the steps outlined in these comments to assure that resulting telecommunications providers are on an equal footing, and can compete for their customers fairly and openly.

Respectfully Submitted,

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